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In the Supreme Court of the United States

OCTOBER TERM, 1983

MALLETTE BROS. CONSTRUCTION COMPANY, ET AL.,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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In this consolidated action seeking refunds of federal income taxes, petitioners seek review of the decision below reversing three judgments on jury verdicts that were entered in favor of the petitioners by the United States District Court for the Southern District of Mississippi (Pet. App. A1-A15).[1] The court of appeals found that there was no competent evidence to support the verdicts (Pet. App. A4-A10).

The pertinent facts may be summarized as follows: This case involves the income tax liabilities of three related corporations—Mallette Brothers Construction Company ("Construction"), Gautier Asphalt Company ("Gautier"), and Mallette Brothers Truck Lines ("Truck") (Pet. App.

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[1]The opinion of the court of appeals (Pet. App. A1-A15) is reported at 695 F.2d 145.

A2-A3). The Internal Revenue Service ("IRS") conducted an examination of all three corporations for their fiscal years ending in 1972 and 1973 (Pet. App. A3). In the course of this examination, the IRS agent found that he could not verify the specific items on the corporations' tax returns from the corporate records (Pet. App. A3; see also II R. 200, 205-209, 213-214, 221-228, 231-232). The agent, therefore, reconstructed each corporation's net taxable income. This reconstruction essentially showed that Construction had diverted some of its income to Gautier and that Gautier had failed to report income from sales of asphalt to Construction (Pet. App. A3-A4).

Based on this audit, the IRS asserted deficiencies against petitioners. Petitioners paid the deficiencies and initiated these actions after their timely filed claims for refunds were denied (Pet. App. A-2).

At the trial, two witnesses testified on behalf of the three corporations (Pet. App. A5). Glynn Mallette testified that he was unable to point out any errors in the agent's examination upon which the deficiencies were based (Pet. App. A6; II R. 61-64). Wynn Alexander testified that it was permissible for one corporation (Construction) to fail to report income earned by it but diverted to a related corporation (Gautier), if the amount diverted was included in the related corporation's gross income. As the court of appeals recognized (Pet. App. A9), however, this position is contrary to the established principle of tax law that income is taxed to the entity that earns it. See *Lucas* v. *Earl*, 281 U.S. 111, 114-115 (1930).

Alternatively, Construction argued that, although it was proper for the Commissioner to adjust its gross income to include the diverted funds, a corresponding entry should have been made to Construction's expense accounts to reflect that the diverted funds were used either to pay for

materials purchased from Gautier or for payroll expenses. Alexander, therefore, concluded that the expenses for asphalt and payroll were understated by approximately the same amount as gross income and, consequently, the taxable income reported on Construction's original return was basically correct (Pet. App. A5-A6). But, the court of appeals noted (*id.* at A7), "[n]o reason was given * * * as to why those expense accounts [for asphalt purchases and payroll] were selected * * * and no testimony was given as to specific amounts omitted from those accounts." Indeed, Alexander admitted that he did not know the amount of asphalt purchased by Construction from Gautier (II R. 148-163), and, therefore, could not have testified as to the correct amount of the asphalt purchases.

Similarly, with respect to the adjustment to Gautier's income to reflect additional income from Construction for sales of asphalt, the court of appeals noted (Pet. App. A9) that Alexander admitted that, if the figures of the examining agent's report (Exh. 8(A)) were correct, the increase in Gautier's income "was also correct." Alexander contended, however, that the examining agent's adjustment to Gautier's income was improper because the agent failed to increase Construction's asphalt purchases account (Pet. App. A9). The court of appeals first held that, even if this were true, Gautier would not be justified in excluding from its gross income amounts that were admittedly income (Pet. App. A9). Furthermore, the court observed (Pet. App. A9-A10) that "the only evidence in the record" on the point was the agent's testimony, and this testimony was to the effect that these additional purchases were in fact taken into consideration in determining Construction's asphalt purchases.

1. The court of appeals' decision is correct, is essentially factbound, and does not present any issue warranting further review. It is well settled that a taxpayer in a refund

suit not only bears the burden of showing that the deficiency asserted by the Commissioner of Internal Revenue is erroneous in some respects, but must also prove the amount he is entitled to recover. *E.g., United States* v. *Janis*, 428 U.S. 433, 440 (1976); *Lewis* v. *Reynolds*, 284 U.S. 281, 283, modified, 284 U.S. 599 (1932). Here, the court of appeals found, after an exhaustive review of the evidence, that neither Construction nor Gautier had offered any credible evidence in support of their refund claims (Pet. App. A2-A3, A8, A10).

2. Petitioners assert that the court of appeals applied an erroneous standard in reversing the jury verdicts. Essentially, they contend (Pet. 20-23) that the court's reversal is based upon its view of the credibility of their witness, Alexander. This is incorrect. The court rejected Alexander's conclusions that petitioners' taxable incomes were properly stated on their returns because these conclusions were predicated upon assumptions that were legally or factually unsupportable. For example, Alexander testified that it was legally permissible for related corporations to shift income earned by one corporation to another as long as one of them reports the income. As the court of appeals pointed out (Pet. App. A9), this premise violates long established principles of tax law. Similarly, with respect to the specifics of whether Construction's and Gautier's reported income and deductions were correct, Alexander either did not know or offered no testimony on the point (Pet. App. A7, A10-A11). Accordingly, there was no legal or factual basis for Alexander's conclusions or for the jury's verdicts, and the court of appeals correctly reversed. See *Brunswick Corp.* v. *Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489-490 (1977) (despite the existence of some "conclusory testimony" in support of the respondent's case, this Court held that the

petitioners were nevertheless entitled to judgment notwithstanding the verdict). See also *United States* v. *Generes*, 405 U.S. 93, 106 (1972).[2]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

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[2]Petitioners allege (Pet. 19) a conflict with *Brady* v. *Southern Ry.*, 320 U.S. 476 (1943). This is without merit. In *Brady*, this Court affirmed the reversal by the North Carolina Supreme Court of a jury verdict. The Court noted (320 U.S. at 480), "[o]ur conclusion is that there was a failure to show in the record any negligence * * *." Similarly here there is no evidence to support petitioners' claims that they overpaid their taxes.

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